

## **Section 109**

### **Introduction**

The Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (“the agencies”), jointly issued a final rule, effective October 10, 1997, that adopts uniform regulations implementing Section 109 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Act).

The Interstate Act allows banks to branch across state lines. Section 109, however, prohibits banks from establishing or acquiring branches pursuant to the Interstate Act outside of their respective home state primarily for the purpose of deposit production. The statute provides a measure to test for compliance with Section 109, including guidelines to ensure that interstate branches are reasonably helping to meet the credit needs of the communities served by the interstate branches.

The language of Section 109 and its legislative history make clear that the agencies are to administer Section 109 without imposing additional regulatory burden on banks. Consequently, the final rule does not impose additional data reporting requirements nor does it require a bank to produce, or assist in producing, relevant data.

## **Coverage**

Section 109 applies to any bank that establishes or acquires a branch under the authority of the Interstate Act or amendments to any other provision of law made by the Interstate Act. It does not apply to national banks that establish branches under other authority (e.g. 12 U.S.C. 30).

## **Definitions**

The term covered interstate branch means any branch of a bank, and any branch of a foreign bank, that is established or acquired outside the bank's home state pursuant to the interstate branching authority granted by the Interstate Act.

For State banks, the term home state means the state that chartered the bank. With respect to a national bank, the term home state means the state in which the main office of the bank is located. With respect to a foreign bank, the term home state is determined in accordance with 12 U.S.C. 3103(c). The term host state means a state in which a bank establishes or acquires a covered interstate branch.

The host state loan-to-deposit ratio is the ratio of total loans in the host state to total deposits from the host state for all banks that have that state as their home state. The host state loan-to-deposit ratio will be calculated annually by the agencies. The statewide loan-to-deposit ratio relates to an individual bank and is the ratio of a bank's loans to its deposits in a particular state where the bank has interstate branches.

## **Requirements**

The determination as to whether a bank is complying with the provisions of Section 109 will be made no earlier than one year after a bank establishes or acquires a covered interstate branch. Section 109 provides a two-step test for determining compliance with the prohibition against interstate deposit production offices. The first step involves a loan-to-deposit (“LTD”) ratio screen, which is designed to measure lending and deposit activities of interstate branches. The LTD ratio screen compares the statewide LTD ratio of a bank's branches to the host state LTD ratio. If the bank's statewide LTD ratio is equal to or greater than one-half of the host state LTD ratio, the bank passes the Section 109 evaluation and no further consideration is required.

If, however, a bank fails the LTD ratio screen or if the screen cannot be applied due to insufficient data, the examiner must perform a credit needs determination analysis. This step requires the examiner to determine whether the bank is reasonably helping to meet the credit needs of the communities served by the bank in the host state. Banks may provide the examiner with any relevant information, including loan data, if a credit needs determination is required.

In reviewing for compliance with Section 109, the examiner should consider the following items in making a credit needs determination:

- ! whether the covered interstate branches were formerly part of a failed or failing depository institution;
- ! whether the covered interstate branches were acquired under circumstances where there was a

- low LTD ratio because of the nature of the acquired institution's business or loan portfolio;
  - ! whether the covered interstate branches have a higher concentration of commercial or credit card lending, trust services, or other specialized activities, including the extent to which the covered interstate branches accept deposits in the host state;
  - ! the most recent ratings (overall rating, multistate MSA rating, and state ratings) received by the bank under the Community Reinvestment Act (CRA);
  - ! economic conditions, including the level of loan demand, within the communities served by the covered interstate branches;
  - ! the safe and sound operation and condition of the bank; and
- the CRA regulation, examination procedures, and interpretations.

Although Section 109 specifically requires the examiner to consider a bank's CRA rating when making a credit needs determination, a bank's CRA rating should not be the only factor considered. However, since most of the above factors are taken into account as part of a bank's performance context under CRA, it is expected that banks with a satisfactory or better CRA rating will receive a favorable credit needs determination and banks with a less than satisfactory CRA rating will receive an adverse credit needs determination unless mitigated by the other factors enumerated in Section 109. To ensure consistency, compliance with Section 109 should be reviewed in conjunction with the evaluation of a bank's CRA performance.

With respect to institutions designated as wholesale or limited purpose banks, a credit needs determination should consider a bank's performance using the special CRA performance test

provided in the CRA regulations. For banks not subject to CRA, including certain special purpose banks and uninsured branches of foreign banks<sup>1</sup>, the examiner should use the CRA regulations only as guidelines when making a credit needs determination for such institutions. Section 109 does not obligate the institution to have a record of performance under the CRA nor does it require the institution to pass any performance tests, as provided in the CRA regulations.

### **Enforcement and Sanctions**

If a bank fails the Section 109 evaluation, the statute outlines sanctions that the appropriate agency can impose. The sanctions are: (i) ordering the closing of the interstate branch in the host state, and (ii) prohibiting the bank from opening a new branch in the host state. Sanctions, however, may not be warranted if a bank provides reasonable assurances to the satisfaction of the agencies that it has an acceptable plan that will reasonably help to meet the credit needs of the communities served, or to be served. In addition, before sanctions are imposed, the agencies stated in the preamble to the final regulation that they intend to consult with state banking authorities.

Before a bank can be sanctioned under Section 109, the appropriate agency is required to demonstrate that the bank failed to comply with the LTD ratio screen **and** failed to reasonably help meet the credit needs of the communities served by the bank in the host state. If a bank receives an adverse credit needs determination, the LTD ratio screen must be applied even if the

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<sup>1</sup> A special purpose bank that does not perform commercial or retail banking services by granting credit to the public in the ordinary course of business is not evaluated for CRA performance by the agencies. In addition, branches of a foreign bank, unless the branches are insured or resulted from an acquisition as described in the International Banking Act, 12 U.S.C. 3101 et seq., are not evaluated for CRA performance by the agencies.

data necessary to calculate the appropriate ratio are not readily available. Since the bank must fail both the LTD ratio screen and the credit needs determination in order to be in noncompliance with Section 109, the agencies have an obligation to apply the LTD ratio screen before seeking sanctions, regardless of the regulatory burden imposed. Consequently, the agencies are required to obtain the necessary data to calculate the bank's statewide LTD ratio before sanctions are imposed.

## **Examination Objectives**

To ensure that a bank is not operating a branch pursuant to the Interstate Act outside of its home state primarily for the purpose of deposit production by determining if a bank's covered interstate branch(es) meets (I) the loan-to-deposit (LTD) ratio screen or (ii) the credit needs determination requirements of Section 109 of the Interstate Act.

## **Examination Procedures**

### **Identification of Branches Subject to a Section 109 Evaluation**

1. Determine if the bank has any covered interstate branches and the date the branches were established. If the bank does not have any covered interstate branches, the bank is not subject to Section 109 and no further review is necessary.
  
2. For the covered interstate branches identified in procedure #1, determine if any of the branches have been in existence for more than one year and therefore subject to Section 109. If none of the bank's covered interstate branches have been in existence for more than one year, no further review is necessary.

### **Assessing Compliance with the LTD Ratio Screen**

3. For the branch(es) subject to Section 109, determine if the bank has sufficient data to

calculate a statewide LTD ratio for each respective host state. (The bank is not required to provide this information or assist in providing this information.) For states where the bank has sufficient data, go to procedure #4. For states where the bank does not have sufficient data, go to procedure #5.

4. For each state where the bank can provide loan and deposit data, calculate and compare the bank's statewide LTD ratio to the applicable host state LTD ratio provided by the agencies. If the bank's statewide LTD ratio equals or exceeds one-half of the host state LTD ratio, the bank passes the LTD ratio screen and the Section 109 evaluation and no further review is necessary. If the bank's statewide LTD ratio is less than one-half of the host state LTD ratio, the bank fails the LTD ratio screen (go to procedure #5).

### **Credit Needs Determination**

5. For each host state identified in procedure #3 or #4, determine whether the bank is reasonably helping to meet the credit needs of communities served by the bank in the host state.

When making this determination, the examiner must consider the following items:

- (i) whether the covered interstate branches were formerly part of a failed or failing depository institution;
- (ii) whether the covered interstate branches were acquired under circumstances where there was a low LTD ratio because of the nature of the acquired institution's business or loan portfolio;
- (iii) whether the covered interstate branches have a higher concentration of commercial or credit



- card lending, trust services, or other specialized activities, including the extent to which the covered interstate branches accept deposits in the host state;
- (iv) the most recent ratings (overall rating, multistate MSA rating, and state ratings) received by the bank under the Community Reinvestment Act (CRA);
  - (v) economic conditions, including the level of loan demand, within the communities served by the covered interstate branches;
  - (vi) the safe and sound operation and condition of the bank; and
  - (vii) the CRA regulation, examination procedures, and interpretations of the regulation.

If the bank passes the credit needs determination test, the bank complies with Section 109 and no further review is necessary. If the bank fails the credit needs determination test but a LTD ratio screen has not been conducted, go to procedure #6. If the bank fails the credit needs determination test and has failed the LTD ratio screen, the bank is in noncompliance with Section 109 (go to procedure #7).

## **Determining Whether Sanctions are Warranted**

6. Calculate the statewide LTD ratio for each host state in which the bank failed the credit needs determination test. The data used to calculate these ratios may be obtained from any reliable source. The institution may, but is not required to, provide the examiner with additional data at any time during the examination. If the bank's statewide LTD ratio(s) is equal to or greater than one-half of the host state LTD ratio, the bank complies with Section 109 requirements and no further review is necessary. If a bank's statewide LTD ratio is less than one-half of the respective host state LTD ratio, the bank is in noncompliance with Section 109 (go to procedure #7).
  
7. Consult agency management to determine whether sanctions are warranted.

## Section 109

### Examination Checklist

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#### IDENTITY BRANCHES SUBJECT TO SECTION 109 EVALUATION

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|---|--|
| 1. Does the bank have any covered interstate branches established pursuant to the | Yes  |
| No  | Riegle-Neal<br>Interstate Banking<br>and Branching<br>Efficiency Act of<br>1994? |

**Note:** If the answer is No, no further review is necessary.

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|---|-----|
| 2. Have any of the bank's covered interstate branches been in existence for more than | Yes |
| No  |     |
| one year?   |     |

**Note:** If the answer is No, no further review is necessary.

#### ASSESS COMPLIANCE WITH THE LOAN-TO-DEPOSIT (LTD) RATIO SCREEN

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|--|-----|
| 3. Does the bank have sufficient data to calculate a statewide LTD ratio(s) for interstate | Yes |
| No   |     |
| branches subject to Section 109?   |     |

**Note:** For each state where the answer is No, proceed to #5.

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|---|-----|
| 4. For each state in which the bank has covered interstate branch, calculate the bank's | Yes |
| No  |     |
| statewide LTD ratio. Is the statewide LTD ratio equal to or greater than one-half of    |     |
| the host state LTD ratio?   |     |

**Note:** For each state where the answer is Yes, the bank complies with Section 109 and no further review is necessary. For each state where the answer is No, proceed to #5.

#### PERFORM CREDIT NEEDS DETERMINATION

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|---|-----|
| 5. For each host state identified in #3 or #4, is the bank reasonably helping to meet the | Yes |
| No  |     |
| credit needs of the communities served by the bank in the host state? When making         |     |
| the determination , the examiner must consider the following items:                       |     |

- ! whether the covered interstate branches were formerly part of the failed or failing depository institution;
- ! whether the covered interstate branches were acquired under circumstances where there was a low LTD ratio because of the nature of the acquired institution's business or loan portfolio;
- ! whether the covered interstate branches have higher concentration of commercial or credit card lending, trust services, or other specialized activities, including the extent to which the covered interstate branches accept deposits in the host state;
- ! the most recent ratings (overall rating, multistate MSA rating, and state ratings) received by the bank under the Community Reinvestment Act (CRA);
- ! economic conditions, including the level of loan demand, within the communities served by the covered interstate branches;
- ! the safe and sound operation and condition of the bank; and
- ! the CRA regulation, examination procedures, and interpretations of this regulation.

**Note:** If the bank passes the credit needs determination test, the bank complies with Section 109 and no further review is necessary. If the bank fails the credit needs determination test and has failed the LTD ratio screen, go to #7. If the bank fails the credit needs determination test but the LTD ratio screen has yet been conducted, go to #6.

#### DETERMINE IF SANCTIONS ARE WARRANTED

6. Calculate the statewide LTD ratio for banks that fail the credit needs determination test. Is this ratio equal to or greater than one-half of the host state LTD ratio?      Yes  
No

**Note:** If the answer is Yes, the bank complies with Section 109 and no further review is necessary. If the answer is No, the bank is in noncompliance with Section 109 (go to #7).

7. After consultation with agency management, are sanctions warranted?      Yes      No